

# Smart Search™

An Indicator of College Admission & Affordability

## Heidi Howard

### Your Colleges

Name	State	Admissibility	EFC Methodology	Cost	EFC	Need	Need Met	Estimated Aid	Net Cost	
Pepperdine University	CA	Likely	Federal	\$52,712	\$3,793	\$48,919	89%	\$43,538	\$9,174	
Stanford University	CA	Far Reach	Institutional	\$55,754	\$4,271	\$51,483	100%	\$51,483	\$4,271	
Yale University	CT	Far Reach	Institutional	\$55,754	\$4,271	\$51,483	100%	\$51,483	\$4,271	
Loyola College	MD	Likely	Institutional	\$52,712	\$4,271	\$48,441	98%	\$47,472	\$5,240	
Duke University	NC	Far Reach	Institutional	\$54,740	\$4,271	\$50,469	100%	\$50,469	\$4,271	
Bucknell University	PA	Likely	Institutional	\$51,699	\$4,271	\$47,428	100%	\$47,428	\$4,271	
Dickinson College	PA	Likely	Institutional	\$53,726	\$4,271	\$49,455	96%	\$47,477	\$6,249	
Lehigh University	PA	Likely	Institutional	\$51,699	\$4,271	\$47,428	98%	\$46,479	\$5,220	
Messiah College	PA	Likely	Federal	\$39,534	\$3,793	\$35,741	61%	\$21,802	\$17,732	

**Affordability Legend:** Funded - Almost Funded - Not Funded - Not Calculated -

### Calculate Affordability

To calculate your family's ability to afford the estimated net cost of each of the colleges above, enter the values of the family's personal resources below that are pledged to help pay for college for this student. Affordability is calculated for four years in college and assumes an annual cost increase of 6%. The color-coded affordability indicator (see legend above) next to the net cost automatically adjusts when values are entered.

<b>Parents' Pledged Assets:</b> Total amount of the parents' assets that you are willing to use for education.	<input type="text" value="6000"/>	<b>Parents' Pledged Monthly Income:</b>	<input type="text" value="100"/>
<b>Student's Pledged Assets:</b> Total amount of the student's assets that you are willing to use for education.	<input type="text" value="1500"/>	<b>Student's Pledged Monthly Income:</b>	<input type="text" value="20"/>
<b>Use Parents' PLUS Loan:</b> Select Yes if Parent's are willing to borrow using the Federal Parent PLUS loan to help cover college costs	<input type="button" value="Yes"/>	<b>Parents' Plus Loan Maximum:</b> Total cumulative amount of PLUS loans parents are willing to take over four years.	<input type="text" value="5000"/>
<b>Use Student Private Loan:</b> Willingness of student to use more expensive private student loans to cover college costs not met by all other sources, in addition to low-cost federal student loans that may be included in the estimated aid at each college.	<input type="button" value="Yes"/>	<b>Student's Private Loan Maximum:</b> Total cumulative amount of private student loans students are willing to take over four years.	<input type="text" value="10000"/>

The Hope Tax Credit (details below) is an education-related tax credit that reduces federal taxes dollar-for-dollar when paying college tuition costs Indirectly, through tax savings, the Hope Tax Credit can act as an additional resource to help families pay college costs The amount of the Hope Tax Credit that the parent's qualify for (for this student) is listed below, and is counted as a personal resource in determining affordability.

### Your Data

<b>Academic Info</b>		<b>Student's Finances</b>		<b>Demographics</b>	
Test Type and Score:	<b>SAT - 1175</b>	Student's AGI:	<b>\$3,000</b>	State of Residence:	<b>PA</b>
High School GPA:	<b>4</b>	Student's Assets:	<b>\$2,000</b>	Age of Oldest Parent:	<b>48</b>
<b>Financial Aid</b>		Student's 529 Plan Assets:	<b>\$0</b>	Number of Dependents:	<b>3</b>
Federal EFC:	<b>\$3,793</b>	<b>Parents' Finances</b>		Number of Students in College:	<b>2</b>
Institutional EFC:	<b>\$4,271</b>	Parents' AGI:	<b>\$70,000</b>	Sum of Ages of Non College Students:	<b>17</b>
Estimated Pell Grant:	<b>\$1,800</b>	Parents' Non-retirement Assets:	<b>\$10,000</b>	Parents' Tax Filing Status:	<b>Joint</b>
Estimated Stafford Load:	<b>\$5,500</b>	Parents' Farm & Business Assets:	<b>\$0</b>	Parents' Tax Return Form:	<b>Form 1040</b>
<b>Tax Aid</b>		Parents' Small Business Assets:	<b>\$0</b>	Hispanic or African-American:	<b>No</b>
Hope Credit:	<b>\$2,500</b>	Parents' Home Equity:	<b>\$5,000</b>		

## Your Notes

Advisor can add notes specific to the student to the report.

## Guide to Your Report

### Admissibility

The Admissibility Indicator (AI) is NOT in any way a guarantee of admission by any college or university. Rather, the Admissibility Indicator (Very Likely, Likely, Possible, Reach and Far Reach) is intended to be a gauge of a student's likelihood of admission at a given college or university as derived from Stratagee's proprietary formula, comparing the academic profile of the college's admitted freshmen class from the previous year and the student's GPA and standardized test scores.

Thus, it is a guide only and should not be construed any other way. Students may choose to apply wherever they have an interest in attending even if the probability of being admitted is unlikely. College admissions trends and policies often reflect institutional priorities which can mean that a student's admissibility could easily change from year to year. Some colleges are so selective that they have become a Far Reach for virtually every candidate, regardless of academic prowess, merit or status as a legacy candidate.

There are many factors that influence a student's overall likelihood of admissibility, of which test scores and GPA are the most concrete and consistent indicators of admissibility. However, while test scores and GPA are the lowest common denominators of admissibility, they are not the student's whole admissions story. Most students have unique qualities and additional factors working for them that can increase their likelihood of admission. These factors are too numerous, far ranging and subjective to include in the scope of this report, especially since college admission policies vary so widely from year to year. These subjective factors must be considered on an individual student and college basis, respectively.

Moreover, in the current economic environment many long-standing admissions trends have been thrown out the window all together. It is a new era in both college admissions and affordability. Public colleges are perceived to be more affordable and therefore have received record numbers of applications, allowing them to be more selective in the admissions process. The elite, most expensive and most selective private colleges are still very expensive (for most students) and very selective (for all students), and they always will be. While typically private colleges are perceived as being more expensive, many have seen declines in applications and have increased their financial aid budgets in order to close the affordability gap. In the end, for some students they may be as affordable as the lower cost public colleges.

Students want to know where they can Get In and Get Aid, and colleges want the best class at the best price.

### EFC Methodology

Expected Family Contribution (EFC) is the minimum amount that a family is expected to contribute toward the cost of attendance at a college or university.

### Institutional and Federal EFC

There are two methods of calculating EFC, the Federal Methodology and the Institutional Methodology. Federal Methodology is used by all colleges to determine a student's need for federal funds, such as Pell grants and Stafford loans. Institutional Methodology is used by over 300 colleges, mostly private, to assess a student's need for aid provided directly from the college's own funds.

## **Two Aid Applications: FAFSA and CSS Profile**

Colleges using Institutional Methodology require that students complete the CSS/Profile application ([www.collegeboard.com](http://www.collegeboard.com)) as well as the FAFSA: Free Application for Federal Student Aid ([www.fafsa.ed.gov](http://www.fafsa.ed.gov)) which most public and private colleges require.

Due to the fact that the CSS/Profile requests much more in-depth financial and family information than the FAFSA, it is common for a student's EFC to vary substantially under the two formulas. The Federal EFC is generally lower than the Institutional EFC for families with higher income and assets, although there are times when families with few assets may have a lower EFC under the Institutional formula.

## **Cost: 2010-2011 Cost of Attendance**

The cost of attendance that is listed for each college that you have selected is the estimated 2010-2011 academic year cost for tuition, fees, room, board, books and travel. This is the projected cost for the 2010-2011 academic year only, one year of college. It is an estimated cost based on each college's published data. However, many colleges may have a slightly higher or lower cost of attendance for specific courses or majors, study abroad and other unique programs.

## **EFC**

The calculation of Expected Family Contribution (EFC) in this Smart Search Report is an estimate based on the Federal Need Analysis Formula and the Institutional Need Analysis Formula (if you chose at least one Profile college) and is not a guarantee of your actual EFC. Smart Search utilizes a streamlined approach to calculating your Institutional and Federal EFC that requests a lot less information than what is typically required. Although streamlined, this approach to EFC calculation still generates an accurate EFC for most families. However, if you itemize deductions on your tax returns, make generous contributions to qualified retirement plans or are self-employed, then your EFC may vary from the Smart Search calculation.

In an effort to utilize the most current information and published formulas, Smart Search is updated on a regular basis. The Federal Need Analysis formula is updated annually with inflation-adjusted changes to various tables in the formula. The federal adjustments for the 2010-2011 academic year were released in June of 2009. Smart Search has already been updated in accordance with these changes. Therefore, because the updates to the two respective formulas (Federal and Institutional) occur at different times, there will be a period during which Smart Search calculates a student's Federal EFC based on the 2010-2011 formula and the Institutional EFC still using the 2009-2010 formula. This is an accepted reality in education funding and in most instances; it will have a minimal impact on a student's Institutional EFC.

The EFC that has been calculated in this report is the EFC of the student for whom you reported income and asset information in step 2. If you have additional students in college at the same time as this student, the additional student(s) will have a specific EFC of their own. Calculation of Expected Family Contribution (EFC) changes from year-to-year based on financial aid laws, tax laws and the assets and income of students and parents.

## **Determining Financial Need**

Financial need is determined by subtracting your Expected Family Contribution from the college's Cost of Attendance (COA - EFC = Need). Thus, depending on a given college's Cost of Attendance, you may have "need" at one college and not at another.

## **Percent of Need Met**

Colleges publish statistics pertaining to their financial aid and admissions outcomes from previous years. One of the most important statistics is the percentage of need met. This is the average percentage of financial need that is met, or awarded, for all students who demonstrate financial need and may be comprised of aid from various sources, such as private aid, state aid, federal aid and the aid from the college itself.

## **Total Estimated Aid**

The total estimated aid is derived by multiplying your need by the percentage of need met. Keep in mind that the percentage of need met is the average among all students at a given college, thus the actual amount of aid you receive, if any, may be substantially higher or lower than the total estimated aid shown in this report.

The total estimated aid represents all forms of aid, and could include federal aid in the form of a Pell grant or Stafford student loan,

if eligible. In the Your Data section above, there is an estimate of the amount of Pell grant and Stafford loan that the student may be eligible to receive (an estimate only, not guaranteed in any way). This estimate is based upon data published by the US Department of Education and is intended to inform you that of the total estimated aid that you MIGHT receive, some of it may be in the form of these two types of federal aid. This estimate of aid is in NO WAY an estimate of what an aid award would consist of in terms of loans, grants, work-study or scholarships at any college. In most cases predicting the make up of a student's overall aid award at any college is nearly impossible since financial aid packaging policies vary among colleges and are influenced by a variety of factors each year. The only types of aid that can be predicted with any amount of consistency are some forms of federal aid and merit aid award programs published by individual colleges.

Merit aid is primarily awarded on the basis of a student's academic merit. Thus, merit aid has nothing to do with a student's and parents' ability to pay. Therefore, even if a student doesn't qualify for need-based financial aid at a given college, the student may still qualify for merit aid that can reduce the overall cost. For example, if the college costs \$35,000 per year and the student is awarded an academic scholarship (merit aid) of \$7,500 because she met the academic criteria of say, at least a 3.5 GPA and an ACT score of 27, then her net cost becomes \$27,500 (\$35,000 - \$7,500).

On the contrary, if the student demonstrated financial need of \$10,000 (\$35,000 cost - \$25,000 EFC) and was awarded the same \$7,500 merit award, the merit award would be applied by the college to meet the student's need first. The result being that the student's \$10,000 of need would be reduced by the \$7,500 award, and if she didn't receive any additional aid her net cost would be \$27,500 (\$35,000 cost - \$7,500 in aid). But, the good news is that most of the student's need was met with a scholarship that doesn't need repaid instead of student loans that do need repaid, with interest.

Merit aid scholarships are highly sought after by qualified students and many colleges publish such scholarships on their websites. However, these scholarships can change from one incoming class to another as a college's aid policy changes. Consequently, even the most diligent database sources of these scholarships are not always accurate and complete. The best way to search for merit aid scholarships is simply to click on the hyperlink to each of the colleges included in this report, look for the financial aid area of the college's website, and contact the financial aid office directly.

There are over 50 private colleges and public universities that have made public their financial aid policies regarding aid awards to students from households of specific income levels. For example, some colleges have made financial aid pledges to meet students' financial need with all grants and others have pledged that students will not be required to take out any student loans. These financial aid policies are very generous toward students, but it remains to be seen if these individual colleges will be able to offer these programs long-term due to heavy losses in college endowment values, enrollment challenges and the overall economic crisis in the US. Thus, Smart Search does not account for these special financial aid pledges when estimating a student's possible financial aid or net cost at a given college. An eligible student may in fact receive a very favorable aid award under one of these programs, and these colleges should still be considered as part of a student's college search process. A list of the colleges and their aid pledges may be found here [http://www.naicu.edu/special\\_initiatives/affordability/about/enhancing-affordability#2009-10](http://www.naicu.edu/special_initiatives/affordability/about/enhancing-affordability#2009-10).

## **Net Cost**

Your Net Cost is the Cost of Attendance minus your total estimated aid at each college or university (COA - Estimated Aid = Net Cost).

Net Cost provides you with an apples-for-apples comparison of your net cost, after your total estimated aid, among both the public and private colleges that you selected. This is especially important if you demonstrate need for financial aid because a private college with a higher sticker price than a public college may turn out to have similar net costs indicating both may be affordable to you.

## **Stafford Loan**

Student Loans are calculated based upon the current maximums for Stafford Loan (both subsidized and unsubsidized). The estimated Stafford Loan listed above is included in the Estimated Aid for each college.

## **Pell Grant**

The Federal Pell grant is awarded based on a student's EFC and the annual cost of the college the student is attending. Only student's with a Federal EFC of less than \$4,618 are eligible to receive a Pell grant award. Students with a Federal EFC of \$100 or less are eligible to receive the maximum Pell grant award of \$5,500 for the 2010-2011 academic year. The estimated Pell Grant listed above is included in the Estimated Aid for each college.

## **Hope Scholarship Tax Credit**

The Hope Scholarship Tax Credit (the Hope Credit) is an example of "Tax Aid." The Hope Credit indirectly "aids" families in reducing the cost of college by reducing the family's federal tax bill. There are three education-related tax benefits: the Hope Scholarship Tax Credit (Hope Credit), the Lifetime Learning Tax Credit (Lifetime Credit) and the tuition and fees deduction. Each of these can help

reduce the overall cost of college and each one has its place in tax planning, but for most families the Hope Credit is likely the best because the Hope Credit got a boost from recent legislation and the other two did not. The Hope Credit previously was worth up to \$1,800 per student, but under the American Opportunity Credit provision in the economic stimulus package, the Hope Credit was increased to \$2,500 per year, per student.

The benefit of claiming the Hope Credit is that it reduces a taxpayer's federal tax bill dollar-for-dollar and puts more money back in the hands of the taxpayer. The new Hope Credit went into effect for the 2009 tax year.

To be eligible for the Hope Credit in 2009 under the new rules married couples filing jointly must have modified adjusted gross income (MAGI) of less than \$160,000, or less than \$80,000 if filing single or as head-of-household (HOH). Married couples with MAGI over \$160,000 (\$80,000 for single and HOH) will be able to claim a partial credit up to \$180,000 (\$90,000), after which their eligibility to claim the credit is completely phased-out.

The new rules also benefit lower income families by making the Hope Credit 40 percent refundable for those families who don't have any federal tax liability. Under the previous rules it didn't do low income families much good to claim the credit because they didn't have any tax due anyway. By making the credit 40 percent refundable it will put up to \$1,000 more per student into the hands of lower income families. However, no portion of the credit is refundable if the taxpayer claiming the credit is a child under age 19 or a college student under age 24 who is providing less than one-half of his or her own support from earned income alone; so long as the child has at least one living parent and does not file a joint tax return.

The new rules also expand from two years to four years the number of years that the credit can be claimed for a student. However, this is a bit misleading since most of the provisions in the stimulus package are only good for two years, 2009 and 2010. However, it is widely anticipated that the new Hope Credit rules will be extended in 2010, or made permanent.

Under these new Hope Credit rules, the amount of the credit equals 100% of the first \$2,000 of qualified tuition and expenses that are paid and 25% of the next \$2,000 of paid expenses. Therefore, the maximum new Hope Credit is \$2,500 per year per eligible student. A family of four with two kids in college could receive as much as \$5,000 in Hope Credits.

The amount of the Hope and Lifetime Credit that can be claimed is calculated based on the amount of qualifying tuition and related expenses (now including books) that were paid at an eligible educational institution. The expenses must be paid on behalf of a qualified student that is the taxpayer, the taxpayer's spouse or the taxpayer's dependent child. To be a qualified student the student must pursue a course of study on at least a halftime basis. A student is considered to pursue a course of study on at least a half-time basis if the student carries at least one half the normal full-time work load for the course of study at an eligible educational institution.

An eligible educational institution is considered to be any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the Department of Education. It includes virtually all accredited public, non-profit, and proprietary (privately owned profit-making) postsecondary institutions. According to IRS Publication 970 qualified education expenses are tuition and related expenses required for enrollment or attendance at an eligible educational institution (described below). Related expenses are student-activity fees and expenses for course-related books, supplies, and equipment that are required as a condition of enrollment or attendance.

## **College Admissions Terms**

### ***Early Decision or ED***

Early decision is a binding contract for the candidate in that if he/she is admitted they must attend. All other applications which might have been filed must be withdrawn. Some colleges have ED I and ED II; both occur usually Nov/Dec/Jan. If the student is not admitted but deferred, the obligation to attend disappears and the application is placed in the regular pool to usually be reread and treated as a regular app.

### ***Early Action or EA***

Early action has the same early deadlines but there is no binding commitment to attend for the student. The college renders a decision and if admitted, the candidate simply has that one in the bag with no obligation to attend. A very few colleges have Single Choice Early Action or Restricted Early Action and that simply means a student may apply to only them on any early basis and not a slew of others. The no obligation rule still applies though. As with any early decision, deposits must be placed before May 1 to hold the spot---no college should require/request one before that date, unethical.

### ***Rolling Admissions***

Rolling admissions (the practice of many public institutions) means that beginning at a certain date in the fall, colleges will read applications which are complete on a continual basis until they fill. Obviously with Rolling Admissions, it pays to get your stuff in early in the cycle as once the spots are allotted, game's over.

# General Financial Planning Options to Consider

## ***Budgeting***

A budget is really just a way to organize and determine how much you plan to spend, and actually spend, on your household expenses each month. Most budgets are organized by categories such as transportation, housing, groceries, utilities, clothing, recreation, etc. The goals of a budget are to keep your finances organized, keep track of where you are spending your money and help you to save as much as possible while maintaining your lifestyle.

## ***Cost-cutting***

When you have a budget it is easier to identify categories in which you can cut costs so that you can save more each month or add to another area of the budget. But, as the Salada tea bag says, "The cost of living is the difference between your net income and your gross habits." Cost-cutting is not always easy. It requires determination and discipline, just like exercise, studying and most other things in life that require commitment. Some habits are hard to break, but the payoff is worth the effort.

For example, eliminating a \$3.33 expense every day (cup of premium coffee), equates to about \$100 per month in savings. Assuming an annual return of 8% per year, that \$100 per month savings can translate into an additional \$31,000 for education costs fourteen years down the road when you enroll your child in a private high school.

If you just can't give up that great cup of coffee every morning because you have been up all night with a newborn, you might be able to save \$100 a month in one of these areas: Insurance premiums, vehicle payments, cell phone plans, eating out, clothing, dry cleaning, memberships, subscriptions, movie rentals, etc. Challenge yourself to see if you can save \$25 a month to start with and then increase it.

## ***Cost Cutting Exercise***

<b>Category</b>	<b>Monthly Ammount</b>
Cell Phone Plans	\$ 0
Cable	\$ 0
Automobile Payments	\$ 0
Travel	\$ 0
Dining Out	\$ 0
Subscriptions	\$ 0
Memberships	\$ 0
Premium Coffee	\$ 0
Energy (utilities)	\$ 0
Landscaping	\$ 0
Pool Maintenance	\$ 0
Lawn Mowing	\$ 0
Groceries	\$ 0
Camps	\$ 0
Activities	\$ 0
Hobbies	\$ 0
Other	\$ 0

**Total Monthly Savings:**

***Debt Reduction/Elimination***

If you have debt, you have to have cash flow (income) to make the payments on that debt. So if you can reduce or eliminate that debt, your cash flow can be used for something else.

The most effective ways to reduce debt are typically thought to be 1) paying off the highest interest loans first and 2) paying off the loan with the smallest balance first, then adding what was being paid on the first loan as an extra payment on the loan with the next highest balance. In the example above, an extra \$100 a month can go a long way toward saving money or, in this case, reducing your debt.

In my experience, the families that consistently come out on top are not the ones with the highest paying jobs or the best mutual fund returns, but rather the families that live within their means and save regularly.

***Debt Consolidation and Refinance***

	<b>Balance</b>	<b>Monthly Payment</b>	<b>Interest Rate</b>
Credit Card	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Credit Card	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Credit Card	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Credit Card	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Home Equity Loan	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Home Equity Line of Credit	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Mortgage	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Personal Loans	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
Student Loans (parents)	\$ <input type="text"/>	\$ <input type="text"/>	<input type="text"/> %
<b>Totals:</b>			

Consider taking a loan to consolidate the highest balances with the highest interest rates. Refinancing a mortgage today might be a challenge with home prices falling and tight lending standards, but interest rates are very low right now and consolidation of debts at these low rates may free up cash flow that can be saved or used to pay education expenses.

***Enhancing Cash Flow (Income)***

Your monthly cash flow, or income, is what drives your budget and gives you the ability to pay your bills. There are two general types of income: income from working (earned income) and income from investments (unearned income). An increase in either one can increase your expected family contribution and decrease your financial aid eligibility. However, don't let the financial aid "tail" wag the income "dog." Make as much money as you can!

***Make more money***

If you have the opportunity to make more money by working some overtime, earning a bonus or getting a bigger commission check from a few extra sales, then go for it. Some parents take on a second job or consulting work to make a little extra to help with private school and college costs, while some stay-at-home parents who have been caring for the children go back to work part-time or full-time when the kids are in school or college. These are all examples of you at work. Now let's talk about how to put your money to work to enhance your cash flow.

***Use your investments to generate cash flow***

Unearned income includes the dividends, interest and capital gains that come from savings and investment products like stock,

mutual funds, bonds, CDs and savings accounts. This income can be reinvested back into the account to help it grow, or you may choose to have it paid out to you. Instead of reinvesting this unearned income, you can take it out of the account (aka: taking the growth off) and use it to help fund education costs, make payments on loans or whatever is most advantageous in your specific situation.

For example, a \$50,000 bond with a 7% yield will generate \$3,500 in interest each year, which could be used to help pay education costs directly instead of taking a \$3,500 student loan. Or you could use the cash flow to make the payments on a loan if you need to take one.

### ***Re-direct contributions to savings and retirement accounts***

Let's say that you have been saving money for your son to attend an independent high school. When the time comes to start paying for that school you could choose to stop making contributions to the investment account and re-direct those contributions and use the money to pay for tuition instead. Likewise, you could reduce, or pause, contributions to your 401k retirement plan instead of taking a loan from your 401k. The nice thing about this tactic is that you can make changes anytime you like.

### ***Payment plans***

Many families use the tactics discussed above to improve their cash flow. But when large tuition bills come due all at once, families often turn to tuition payment plans to "spread out" those larger bills over a period of months instead of borrowing the money or liquidating an investment account.

Tuition payment plans are offered through the schools, but are usually administered by outside payment plan companies. These plans are a good solution for many families that may have an adequate income stream to pay the bill, but just can't do it all at one time. Commonly there is an annual fee of between \$35-\$75 dollars per student to administer the plan, but neither the school nor the plan will charge any interest for the convenience of being able to pay tuition bills over a series of months.

### ***Direct Gifts and Prepayments of Tuition***

Some parents and grandparents can benefit from making direct gifts of cash to pay for tuition because it removes assets from their taxable estate which may help them reduce income and estate taxes in the future. Recent events have opened the door for prepaying tuition as well.

A word of caution is warranted here. If parents or students receive gifts of money, the amount of the gifts will likely decrease the student's eligibility for need-based financial aid, which may or may not be of concern to the family.

### ***Direct Gifts for Tuition***

Annual gifts of up to \$13,000 per person (\$26,000 for joint returns) can be made annually without having to pay gift tax. However, special gift tax rules exempt payments for qualified medical and education expenses from gift tax. These non-taxable gifts are an excellent way to provide substantial value to the person receiving the gifts (donees) and favorable tax benefits for the people making the gifts (donors). To qualify for the exception for education expenses, payment must be made directly to a qualified educational institution and must be for tuition only, and not room and board.

Qualified educational institutions include K-12 private schools; colleges and universities; and proprietary (privately owned profit making) secondary institutions.

Making direct gifts to pay for tuition does not impact the ability to make annual tax-free gifts of \$13,000 or less under the annual exclusion. So a wealthy grandparent can make direct payments of tuition to a grandchild's college or K-12 private school as well as gift \$13,000/\$26,000 to the same grandchild in the same year without having to pay gift tax.

### ***Prepayment of Tuition***

If a little is good than more must be better. A recent development relating to the direct payment of tuition involves prepaying tuition expenses for multiple years in advance instead of just the current year. The IRS ruled in a private letter ruling on 1/13/2006 (number 200602002) that, subject to certain conditions, multiple year prepayments of tuition are not considered taxable gifts for gift or Generation Skipping Tax (GST) purposes.

Essentially prepayment of tuition follows the same rules as direct gifts with the following conditions: The taxpayer should not receive any discounts or refunds (even if the student stops attending the school/college) and the payments should not guarantee enrollment or offer any special consideration to the student or donor.

Because of the nature of the IRS ruling, prepaid tuition gifts should be completed carefully and with legal advice regarding the non-taxability of the gift. The prepayment of tuition obviously involves the risk of losing the prepaid money if the child chooses not to

attend the school that the prepayment was made to or if he transfers, drops out, or is expelled from the school. Once the money is prepaid it belongs to the school and cannot be recovered.

## **Description and Comparison of Types of Loans**

Sometimes taking loans is necessary in order to pay for private school and college. The following is an overview of the common types of loans associated with education funding, followed by a bit of guidance to help you understand which loan(s) might be best for you and your child.

### ***Federal Stafford Loans (Subsidized and Unsubsidized)***

The Stafford loan is the most common loan that students use to pay for college. If the student qualifies for a subsidized loan, the federal government pays the interest on the loan while the student is in college - hence the term "subsidized." Almost any student can get an unsubsidized loan, with the difference being that the student is responsible for paying the interest on the loan while he is in college, although the interest payments can be deferred until shortly after the student graduates or leaves college. The amount of both types of Stafford loans for undergraduate students is based on the student's standing in college. The maximum loan amount is \$5,500 for freshmen, \$6,500 for sophomores and \$6,500 for juniors and seniors, with an aggregate maximum loan amount of \$31,000 per student.

### ***Parent PLUS Loans***

This federal loan is offered through colleges to parents with relatively good credit. The interest rate on this loan is capped at 8.5%, and repayment begins shortly after the funds are disbursed. The maximum PLUS loan amount is the difference between the college's cost of attendance and all of the other aid that your child has been awarded.

### ***Perkins Loans***

The Perkins loan is awarded by participating colleges to students with exceptional financial need and has an interest rate of 5%. The maximum amount for this loan is \$4,000 per year with an aggregate maximum of \$20,000 per student.

### ***Alternative Student Loans***

These loans are offered to students by a variety of banks and private lenders and typically carry very high interest rates, fees and other charges. They should be called "No Alternative Loans" because they should be your last resort.

### ***Mortgage and Home Equity Loans***

It is not uncommon for parents to take out a new mortgage on their home in order to pay for college. After all, most parents have the majority of their net worth tied up in their homes (and their 401k or other retirement plans).

A cash-out refinance of a mortgage is when the borrower refinances an existing loan by taking a new mortgage for an amount that is higher than the existing loan. The lender then pays off the existing mortgage and gives the borrower "cash-out" of their home in the amount of the difference between the new higher loan and what was owed on the existing loan.

By contrast, re-mortgaging a home simply means to take out a new loan equal to what is currently owed, but usually at a different interest rate and a different period of repayment. Essentially the goal in re-mortgaging an existing loan is to reduce the payment by getting a lower interest rate, stretching out the payments over a longer period of time, or both.

Instead of taking a mortgage against your home, you can also tap into your home's equity by taking a home equity loan where you get cash-out up front and have a variable or fixed interest rate for a fixed period of time. Or you can get a home equity line of credit (HELOC). A HELOC is a line of credit that you can draw on when you want, and then make payments according to the amount of the available credit that you use. The interest rate is usually variable.

Mortgages can come with fixed, variable and adjustable interest rates, and typically offer longer terms of repayment than home equity loans. One good thing is that the interest can be tax deductible for most taxpayers who itemize their deductions on their tax return.

However, ALL of these loans are collateralized by your home, and if you can't make the payments on the loan, the lender can foreclose on the loan and you can lose your home.

### ***Intra-Family Loans***

The two big advantages of this type of loan are - typically lower interest rates and little or no paperwork to get "approved" for the

loan. They also have one big downside, which is the fact that you are borrowing from your family and if you don't repay the loan according to the terms agreed upon it can cause stress within the family.

### ***Life Insurance Cash Value Loan***

Whole life, variable life and universal life insurance policies all have a cash value component that can be borrowed against. The interest rates for loans on these types of policies will vary among companies and policies, but generally range from 5%-9% annually. As the owner of the policy, you determine when to repay the loan. However, if you don't at least pay the interest on the loan each year, the interest charges from the loan will begin to eat away at your cash value and could eventually put your policy at risk of having insufficient cash value to stay in force over time, even if you continue to pay the normal premiums.

### ***401k Loans***

In most households these days, at least one parent has a 401k retirement plan through their employer and makes regular contributions to the plan directly out of their paycheck. Most of these plans have a loan provision that permits account owners to borrow from their savings. The maximum loan by law is 50% of the vested account balance, and must be repaid within five years through payroll deductions. The interest rate is set by the plan and is usually tied to the prime rate. The problem with 401k loans is that you have to repay them over such a short period of time (five years). If you fail to do so, the unpaid balance of the loan is treated as a non-qualified withdrawal and therefore is subject to ordinary income tax rates plus a 10% excise tax (penalty) if you are not over age 59 1/2.

### ***Summary of Loans for Students***

Various studies have shown that when students are at least partially responsible for paying for their own college education - by way of work-study, using their own money or taking out student loans - they tend to do better academically than students who are not responsible for any share of their education costs. As parents, if you want your child to be responsible for paying a part of her college costs and she will need a loan to do so, you can either lend her the money yourself (Intra-family loan) or let her take out a student loan. Depending on whether she demonstrates a financial need, exceptional financial need or no financial need at the college that she attends, she will end up with a subsidized Stafford loan, a Perkins loan, an unsubsidized Stafford loan and/or an Alternative loan.

In general, the best loans are the subsidized Stafford and Perkins loans followed by the unsubsidized Stafford loan, and as a last resort, the Alternative loan.

Special offers from lenders change constantly for these loans, so it may require some homework using the internet and by talking with your private school/college to determine which lender has the best overall rates, origination fees and repayment terms.

### ***Summary of Loans for Parents***

Generally, mortgages offer the longest terms of repayment with the lowest interest rates, and the interest for some taxpayers is even tax deductible. For these reasons mortgages frequently have the lowest monthly payments for a given amount of borrowed money. Home equity loans and lines of credit have to be repaid over shorter periods of time at higher rates of interest, so their payments tend to be higher than mortgages. But remember that all of these types of loans require a credit check and are collateralized by your home.

Intra-family and life insurance cash value loans don't require a credit check and can be paid back on more flexible terms and decent rates of interest.

Parent PLUS Loans are a good option for parents who don't have a home or don't have enough home equity to tap into. In fact some lenders argue that for education purposes a Parent PLUS Loan might be better than a mortgage or home equity loan since the loan isn't collateralized by your home, the interest rate is fixed and can be tax deductible, it has slightly more repayment flexibility during financially challenging times and is insured against death and disability.

401k loans have to be repaid over shorter time periods than the other loans and usually have a higher rate of interest that is not tax deductible.

## **More Information on Paying for College**

For more information on paying for college, please visit [www.stratagee.com](http://www.stratagee.com).

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